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Fitch: Medicare Advantage Challenges Credit Neutral for U.S. Health Care Industry

Fitch Ratings-New York/Chicago/Austin-07 February 2024: Recent instability in Medicare Advantage (MA), driven by a convergence of program adjustments and an unexpected increase in utilization, has muddled the outlook for the program, but is expected to be largely credit-neutral for most rated health insurers and healthcare providers, Fitch Ratings says.

Some of the disruption in MA reflects renewed efforts by the Centers for Medicare and Medicaid Services (CMS) to rein in the rate of growth in expenditures for the Medicare program while attempting to maintain stable coverage for U.S. seniors. The recent tightening within the program follows a moderate relaxation of funding constraints during the pandemic to deal with morbidity associated with Covid-19 infections.

For U.S. health insurers, weaker payment rates combined with changes in the Star Ratings program and the risk adjustment model are increasing complexity in benefit offerings and pricing decisions. An increase in utilization beginning in 2023, driven in large part by the return of elective procedures that were deferred during the pandemic, has placed upward pressure on medical loss ratios for the MA business, and new rules around prior authorizations will likely further increase costs. The adverse effect of this elevated utilization has been most pronounced for insurers with high proportional exposure to MA business.

Fitch-rated health insurers generally have sufficient ratings headroom to withstand higher MA utilization rates, with broader medical loss ratios remaining within ratings expectations for most insurers. We expect stability to return to the business over the next 12 to 18 months as the higher utilization and hangover effects from the pandemic normalize and carriers adjust to administrative changes in the program.

While these developments appear to be placing downward pressure on MA margins for insurers, the popularity of such programs may promote a modest positive in terms of volume for some provider systems. For-profit health systems in particular benefitted in 2023 from above-average same-facility volume growth, including an upturn in inpatient volumes, which have experienced headwinds in recent years from outmigration of lower-complexity surgical procedures to outpatient settings, including ambulatory surgery centers.

The aforementioned increase in Medicare Advantage patient volumes has played a key role in the overall volume upturn, which helped stabilize provider margins and operating performance generally after a challenging 2022. During 2022, pandemic-constrained labor availability posed headwinds to both volumes and compensation costs, the latter including high temporary labor costs that notably receded over the course of 2023.

Despite the positive volume aspect of increased utilization for provider systems, however, there appears to be a growing trend, particularly among some not-for-profit providers, to exit network contracts with some MA insurers. Reasons often cited by the systems include administrative

challenges, slow payments and denial of prior authorizations for care.

MA business is more exposed to federal government intervention and oversight relative to commercial business. It typically generates moderately lower EBITDA-based margins for health insurers relative to commercial membership, although absolute earnings per member are generally higher. In 2023, 30.8 million people were enrolled in MA, or 51% of the eligible Medicare population, and accounted for $454 billion (or 54%) of total federal Medicare spending, according to the Kaiser Foundation. UnitedHealthcare and Humana comprise nearly half (47%) of all Medicare Advantage enrollees nationwide.

The MA business will continue to be an important focus of U.S. health insurers, despite the current modest disruption. As the U.S. population continues to age, resulting in new beneficiaries eligible for the program, Medicare Advantage will continue to be a strong source of revenue growth for health insurers and healthcare providers in the coming years.

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